No. 16-1454

IN THE

Supreme Court of the United States

STATES OF OHIO, *et al.*,
Petitioners,

v.

AMERICAN EXPRESS COMPANY, *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF FOR *AMICI CURIAE* AHOLD U.S.A., INC.; ALBERTSONS LLC; THE GREAT ATLANTIC AND PACIFIC TEA COMPANY, INC.; H.E. BUTT GROCERY CO.; HY-VEE, INC.; THE KROGER CO.; MEIJER, INC.; PUBLIX SUPER MARKETS, INC.; RALEY'S; RITE AID CORPORATION; SAFEWAY INC.; SUPERVALU, INC.; AND WALGREEN CO. IN SUPPORT OF PETITIONERS

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STATEMENT OF *AMICI CURIAE* INTERESTS

Amici are some of the largest supermarket and drugstore chains in the U.S.[1] All of the *Amici* purchase Amex merchant services. Credit card fees are among the largest and fastest-growing expenses for *Amici*. The source of those high fees is the total lack of interbrand price competition for credit card merchant services.

Amici are among the millions of U.S. merchants who the district court found "cannot inject price competition into the network services industry by encouraging their customers to use their lowest-cost supplier, as they can in other aspects of their business." Pet. App. 198a. Because of the American Express Company's ("Amex") anti-steering rules and the decision of the Second Circuit, *Amici* and millions of other merchants continue to operate without the benefit of price competition for a critical service whose price is ever-increasing. Those increasing prices leave the *Amici* and other merchants in the position of being unable to control their costs or efficiently operate their businesses.

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[1] The parties have consented to the filing of this brief. No party's counsel authored any part of this brief. No party or party's counsel contributed any money to fund the preparation or submission of this brief. No persons or entity other than the *Amici* or their counsel contributed any money to fund the preparation or submission of this the brief. The *Amici* are: Ahold U.S.A., Inc.; Albertsons LLC; The Great Atlantic and Pacific Tea Company, Inc.; H.E. Butt Grocery Co.; Hy-Vee, Inc.; The Kroger Co.; Meijer, Inc.; Publix Super Markets, Inc.; Raley's; Rite Aid Corporation; Safeway Inc.; Supervalu, Inc.; and Walgreen Co.

SUMMARY OF ARGUMENT

The Second Circuit did not disturb the district court's finding that Amex's anti-steering rules obstruct interbrand price competition between Amex, MasterCard, Visa and Discover for the sale of credit card services to merchants. More specifically, the district court held that if a merchant could use discounts or other incentives to encourage their consumers to use less expensive payment cards, they would do so and consumers would respond by switching away from Amex to less-expensive payment cards in order to avail themselves of the merchant-offered discounts, benefits or incentives. Faced with a loss of sales volume due to its comparatively high merchant prices and merchant steering, Amex or other high-priced credit card networks would reduce their prices so that merchants would steer consumers to them, rather than away from them. Pet. App. 217a. The resulting price competition among the credit card networks to obtain greater sales by lowering price would drive down the prices charged by all four of the credit card networks to merchants. *Id.* at 216a-17a. If a credit card network, such as Amex, refused to compete on price and lower its merchant prices to a lower competitive level, it would suffer the procompetitive consequences – the loss of sales due to its comparatively high price.[2]

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[2] The Amex contention that its fees cannot be determined to be supracompetitive without considering Amex's costs and profit margin is incorrect. If Amex's anti-steering rules stifle interbrand price competition (as the District Court found – Pet. App. 192a) and Amex's prices would go down if that price competition was allowed to occur (as the District Court also found - Pet. App. 217a), then Amex's prices are, by definition, above the rate that would prevail under competitive conditions.

Although the Second Circuit did not disturb the district court's finding of an injury to price competition among Amex, MasterCard, Visa and Discover for the sale of credit card services to merchants, it did hold that (1) the relevant product market necessarily includes the sale by Amex of credit card services to both merchants and cardholders, and (2) the Government did not make out a *prima facie* case of injury to competition because it did not prove that the injury to price competition for the sale of services to merchants was not outweighed by hypothetical benefits to competition for the sale of services to cardholders. Pet. App. 32a, 43a-44a, 53a. The district court's ruling that Amex had failed to come forward with any evidence of offsetting procompetitive effects was deemed irrelevant, because the Government had not made out a *prima facie* case and the burden of coming forward with evidence of offsetting, procompetitive effects therefore never shifted to Amex.

First, the Second Circuit's relevant market analysis is incorrect as a matter of law. It is only products or services that are close substitutes for each other and exhibit a high degree of cross-elasticity of demand that belong in the same relevant market. Cardholder network services are not a substitute for and exhibit no cross-elasticity of demand with merchant network services. They do not belong in the same relevant market. Furthermore, in a case such as this, where cardholder and merchant network services cannot be in the same relevant market—and where the Government proved by direct evidence that Amex's anti-steering rules injured interbrand price competition for the sale of network services to merchants—there is no further need to engage in "detailed market analysis" in order to prove a Rule of Reason violation. *See FTC v. Ind. Fed'n of Dentists*, 476 U.S. 447, 460 (1986).

Second, the Appellate Court erred, both legally and factually, in holding that the Government did not establish an injury to competition and that Amex was not obligated under the Rule of Reason to come forward with evidence of offsetting procompetitive effects. As a factual matter, the Second Circuit left undisturbed the district court's finding that Amex's anti-steering rules caused the following injuries to competition: (1) the anti-steering rules injured inter-brand price competition for the sale of credit card services to merchants, which, at a minimum, injures competition with regard to a component of a two-sided price and, by itself, constitutes an injury to competition; (2) erected barriers to entry or expansion into a highly concentrated industry; (3) eliminated consumer choice; and (4) injured retail consumers by raising the price they pay for goods and services. Individually and collectively these injuries to competition violate the Rule of Reason unless there are offsetting pro-competitive effects. Amex bore the burden of coming forward with evidence of such procompetitive effects. The district court found that Amex failed to do so. Pet. App. 229a. The Second Circuit leaves that finding, too, undisturbed.

The Second Circuit did identify two hypothetical justifications for Amex's anti-steering rules. First, it stated that Amex needs to "balance" the price it charges to merchants and the price it charges cardholders. Second, it held that because Amex might use some of the supracompetitive price it extracts from merchants to increase cardholder rewards (*i.e.*, lower cardholder price), that its conduct might be beneficial. Neither of these supposed justifications have merit. Nor do the rewards given to Amex cardholders as a result of its supracompetitive merchant prices constitute a procompetitive "net" benefit to even a two-sided

market. The supracompetitive merchant prices are passed on to all consumers in the form of higher retail prices, but the rewards are not passed on to all consumers. The vast majority of consumers do not use Amex cards; receive no Amex rewards; and suffer a deadweight loss. Only a fraction of the merchant fees collected by Amex are passed on to even its cardholders. Contrary to the Second Circuit's assumption, the Amex rewards are not free. They impose a cost on all consumers, only a fraction of which is passed on to only a fraction of those consumers.

ARGUMENT

I. Because the Government Proved by Direct Evidence that Amex Injured Interbrand Price Competition For the Sale of Merchant Services, There Was No Need for Further Detailed Market Analysis

The Second Circuit held that the "District Court's definition of the relevant market in this case is fatal to its conclusion that Amex violated §1." Pet. App. 31a. According to the Second Circuit, the district court should have "collapsed" the market for the sale of services to cardholders and the market for the sale of services to merchants into one "platform-wide market." Pet. App. 32a. The card-issuing services sold to cardholders and the card acceptance services sold to merchants are not, however, interchangeable products and exhibit neither substitutability nor cross-elasticity of demand. If the price of card acceptance services goes up, a merchant cannot shift to purchasing cardholder services and vice versa. The services are not substitute products. They exhibit no cross-elasticity of demand and cannot be placed in the same relevant market. *Brown Shoe Co. v. U.S.*, 370 U.S. 294, 325 (1962) ("[t]he outer boundaries of a product market are

determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it"); *U.S. v. E.I. DuPont de Nemours & Co.*, 351 U.S. 377, 404 (1956) (relevant market includes products that have "reasonable interchangeability for the purposes for which they are produced"). Indeed, far from being substitutes, merchant services and cardholder services are actually complementary products. *See* Phillip E. Areeda & Herbert J. Hovenkamp, *Antitrust Law: An Analysis of Antitrust Principles and Their Application*, 2017 Supp., ¶565, p. 104 (June 2017) (stating that the Second Circuit erred because Amex's merchant and cardholder services "are not substitutes for one another but rather behave more like complements").

Where, as here, cardholder network services and merchant network services cannot be in the same relevant market as a matter of law, and the elimination of interbrand price competition is proved with direct evidence, there is no need to engage in further detailed market analysis. The purpose of defining a relevant market is to determine whether the defendant has sufficient market power to injure competition. The existence of such market power may be determined by defining the market; measuring the defendant's market share; and inferring from a high market share that the defendant has sufficient power to injure competition. *Tops Mkts., Inc. v. Quality Mkts., Inc.*, 142 F.3d 96, 98-99 (2d Cir. 1998). Such detailed measurement of the market is not, however, always necessary. Where there is sufficient direct proof that the defendant has injured industry-wide interbrand price competition, there is no need to separately determine whether the defendant has sufficient market power to injure competition. It is already established that the defendant has such power and has exercised

it. As a result, there is no need for further market analysis from which such power might be inferred.

The controlling authority is this Court's decision in *FTC v. Indiana Federation of Dentists*, 476 U.S. 447 (1986). In that case, a group of dentists agreed that they would not make X-rays available to insurance companies even if patients asked them to do so. The FTC's finding of a §1 Sherman Act violation was reversed by the Seventh Circuit because the FTC had failed to offer a "definition of the market in which the Federation was alleged to have restrained competition and to establish that the Federation had the power to restrain competition in that market." *Id.* at 453. This Court reversed the Seventh Circuit ruling. It held that the "Commission's failure to engage in detailed market analysis is not fatal to its finding of a violation of the Rule of Reason." *Id.* at 460.

This Court reasoned that the FTC had shown actual adverse effects on competition because patients were unable to obtain the services they demanded and insurers were "actually unable to obtain compliance with their requests for submission of x-rays . . ." *Id.* This Court then held that the proof of "actual, sustained adverse effects on competition" obviated the need for further market analysis:

> Since the purpose of the inquiries into market definition and market power is to determine whether an arrangement has the potential for genuine adverse effects on competition, "proof of actual detrimental effects, such as a reduction of output," can obviate the need for an inquiry into market power, which is but a "surrogate for detrimental effects." 7 P. Areeda, Antitrust Law ¶1511, p. 429 (1986). In this case, we conclude that the finding of

> actual, sustained adverse effects on competition . . . is legally sufficient to support a finding that the challenged restraint was unreasonable even in the absence of elaborate market analysis.

476 U.S. at 460-61.

The current case is remarkably similar. Here, the Government proved an adverse effect on interbrand price competition among all four credit card networks. Amex's anti-steering rules did not just impact a competitor. Its anti-steering rules eliminated price competition on an industry-wide basis and resulted in all four networks charging supracompetitive prices to all merchants.[3] Under this Court's precedent, the exclusion of cardholders from the relevant market and the direct proof of actual adverse effects on industry-wide price competition for the sale of services to merchants obviates the need to engage in a more detailed relevant market analysis so as to measure Amex's power and infer from it Amex's ability to injure interbrand competition.

II. The Government Proved an Injury to Competition

The Second Circuit held that the Government did not demonstrate a *prima facie* injury to competition because it did not prove that the price paid by merchants to Amex went up more than the price paid by cardholders to Amex went down. Pet. App. 53a (holding that the Government did not show an

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[3] Merchants who accept Amex cards account for more than 90% of the retail sales in the U.S. (measured by dollar volume of sales). Pet. App. 188a, n.40.

anticompetitive effect because it failed to offer "evidence of the net price affecting consumers on both sides of the platform" and failed to provide "a reliable measure of American Express's two-sided price that appropriately accounts for the value or cost of the rewards paid to cardholders"). This holding ignores undisputed findings of fact and incorrectly focuses only on the Amex price while ignoring the injury to price competition between Amex, MasterCard, Visa and Discover. The Second Circuit Opinion also ignores the unchallenged findings that Amex's anti-steering rules (1) erected barriers to entry or expansion into an already highly concentrated market; (2) stifled consumer choice; and (3) caused all consumers to pay higher retail prices regardless of the payment form they use or the rewards they receive.

A. The Government Proved an Injury to Interbrand Price Competition

The district court found that Amex's anti-steering rules obstruct interbrand price competition between MasterCard, Visa, Amex and Discover and cause the merchant prices charged by all four of those card networks to be higher than they otherwise would be. Pet. App. 192a. The Second Circuit Opinion ignores these findings and focuses instead on the question of whether the net Amex price to merchants and to cardholders goes up. But even if the Amex net two-sided price does not go up (as explained below, it does), the Amex anti-steering rules nonetheless eliminate the competitive incentive that Discover, MasterCard and Visa would otherwise have to compete on price by lowering their merchant fees because, in the absence of merchant steering, a card network's lower merchant price will not be rewarded with greater network sales. Pet. App. 192a, 195-98a. The result is that price

competition among all four of the credit card networks is eliminated and the prices charged by all four of the networks are "dramatically" higher than they otherwise would be. Pet. App. 71a, 192a, 195a-98a. The Second Circuit Opinion omits all reference to these dispositive, undisputed findings by the district court.

Furthermore, even if one assumes (incorrectly) that the relevant market includes both sides of the two-sided platform, and that the net price to both sides must be considered, an injury to competition within the meaning of the Sherman Act is still clearly present. In *Catalano v. Target Sales*, 446 U.S. 643 (1980), the defendants obstructed competition over credit terms. This Court held that credit terms were "an inseparable *part* of price" and that the agreement in question was an unlawful restraint. *Id.* at 648. Similarly here, even if Amex operates a two-sided platform and collects a net two-sided price, the merchant price is nonetheless an "inseparable part" of that net two-sided price. At the very least, Amex was, therefore, found to have obstructed competition with regard to an inseparable component of price. According to *Catalano*, that constitutes an actionable injury to competition. That injury must be justified by evidence of offsetting procompetitive effects if it is to withstand scrutiny under the Rule of Reason; and it is Amex's burden to come forward with such evidence.[4] The Second Circuit did not even assert that Amex did so.

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[4] *See FTC v. Actavis*, 133 S. Ct. 2223, 2236 (2013) (holding that "[a]n antitrust defendant may show . . . legitimate justifications are present" in order to show lawfulness under the Rule of Reason); *Cal. Dental Ass'n. v. FTC*, 526 U.S. 756, 788 (1999) (Breyer, J. concurring in part) ("[T]he defendant bears the burden of establishing a procompetitive justification"); Areeda & Hovenkamp, *Antitrust Law*, 2017 Supplement, ¶1505, p. 171

B. The Government Proved that Amex Erected Barriers to Entry or Expansion into a Highly Concentrated Industry

The Second Circuit acknowledged that credit cards are a highly concentrated industry in which Visa has a 45% share, Amex a 26.4% share, MasterCard a 23% share and Discover a 5.3% share.[5] Pet. App. 13a. The Second Circuit also acknowledged that the credit card industry is "characterized by formidable barriers to entry." Pet. App. 17a. In that setting, the district court held that Amex's anti-steering rules erect further barriers to entry and "render it nearly impossible for a firm to enter the relevant market" by offering a lower-priced service. Pet. App. 203a. The district court specifically pointed to Discover as a network that attempted to expand its market position by offering merchants progressively lower prices in return for the merchant steering customers to the Discover card. *Id.* The district court found that because of the Amex anti-steering rules "Discover or any potential new entrant" was denied the opportunity to offer lower merchant fees in return for greater sales and it was nearly

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(stating that in the *Amex* case the Government met its burden of showing a *prima facie* case and that the "burden should [have] shift[ed] to [Amex] to show a justification.").

[5] In the courts below, Amex repeatedly claimed that the credit card market is dominated by its "larger competitors," MasterCard and Visa. In fact, Amex's market share is larger than MasterCard's. The Herfindahl-Hirschman Index ("HHI") is a measure of market concentration that is calculated by summing the squares of the shares of the industry participants. The HHI for the credit card industry is 3279. According to the 2010 U.S. Department of Justice and FTC Horizontal Merger Guidelines, §5.3, an HHI of 2500 or more indicates a highly concentrated market.

impossible for a competitor to enter the market "by offering merchants a low-cost alternative to existing networks." *Id.* The district court further found that Amex's anti-steering rules thereby "impede modes of competition that likely would benefit consumers on both sides of the [credit card] platform." *Id.* Amex did not challenge any of these findings on appeal. The Second Circuit Opinion fails to mention these critical facts.

This Court has repeatedly held that the erection of barriers to entry or expansion constitutes an adverse effect on competition. In *Eastman Kodak Co. v. Image Tech. Servs., Inc.*, 504 U.S. 451, 485 (1992), this Court stated that "one of the evils proscribed by the antitrust laws is the creation of entry barriers to potential competitors[.]" *See also U.S. v. Am. Tobacco Co.*, 221 U.S. 106, 183 (1922) (defendants' conduct held anticompetitive, in part, because it erected "perpetual barriers to entry of others into the tobacco trade"); *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 14 (1984) (holding conduct to be anticompetitive if it "could either harm existing competitors or create barriers to entry of new competitors . . ."), *abrogated on other grounds by Ill. Tool Works, Inc. v. Indep. Ink, Inc.*, 547 U.S. 28 (2006). The erection of barriers to entry or expansion is particularly problematic (1) where, as here, the market is already highly concentrated (*FTC v. Consol. Foods Corp.*, 380 U.S. 592, 601 (1965) (finding anticompetitive conduct because the "oligopoly structure of the industry is strengthened and solidified and new entry is discouraged")) or (2) where a small, aggressive competitor, such as Discover, stands ready, willing and able to compete by

offering lower prices, but is thwarted by the defendants' conduct (Pet. App. 205a-06a[6]); *see FTC v. Proctor & Gamble Co.*, 386 U.S. 568, 578 (1967) (conduct in question held anticompetitive where it "may substantially reduce the competitive structure of the industry by raising entry barriers and dissuading the smaller firms from aggressively competing").[7]

Amex has never offered evidence of a procompetitive justification for erecting barriers to entry or expansion by alternative credit card networks. Those networks, had they been able to enter or expand in that market, would have competed on both sides of the platform and would have deconcentrated the highly concentrated credit card market to the benefit of both merchants and cardholders, alike. In the district court, Amex did not "strenuously dispute the evidence regarding the effect of anti-steering rules on Discover's low-price model, or that such restrictions effectively raise a barrier to entry" for firms that would offer lower prices. Pet. App. 205a-06a. In the Second Circuit, Amex omitted all reference to the findings that its anti-steering rules raise barriers to entry into a highly concentrated market by would-be price-cutters. The erection of such barriers to entry, by itself, constitutes an actionable injury to competition on both sides of the credit card platform. Amex has never attempted to

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[6] The CEO of Discover testified that Discover is still prepared to offer lower prices to merchants while offering competitive rewards to cardholders if the Amex anti-steering rules are removed. Pet. App. 219a,

[7] Amex's anti-steering rules also prevented two merchant-owned card networks from entering the highly concentrated credit card market. Pet. App. 213a-14a.

justify that injury to competition under the Rule of Reason and the district court judgment in favor of the Government may be affirmed on that ground alone.

C. The Government Proved that Amex's Anti-Steering Rules Injured Consumer Choice

One of the primary purposes of the Sherman Act is to maximize consumer choice. *Associated Gen. Contractors v. Cal. State Council*, 459 U.S. 519, 528 (1983) ("activity that prevents its victims from making free choices between market alternatives is inherently destructive of competitive conditions and may be condemned even without proof of its actual market effect"); *Ind. Fed'n of Dentists*, 476 U.S. at 459 ("[a]n agreement limiting consumer choice by impeding the ordinary give and take of the market place . . . cannot be sustained under the Rule of Reason"); *NCAA v. Bd. of Regents*, 468 U.S. 85, 107 (1984) ("[A] restraint that has the effect of reducing the importance of consumer preference in setting price" is inconsistent "with this fundamental goal of antitrust law"); *Nat'l Soc'y of Prof'l Eng'rs v. U.S.*, 435 U.S. 679, 693-94 (1978) (conduct that "substantially deprives the customer of the ability to utilize and compare prices" adversely affects competition) (internal quotation omitted).

The explicit purpose and competitive effect of Amex's anti-steering rules is to prevent consumers from being offered a competitive choice. The anti-steering rules specifically prohibit merchants from offering a customer (1) a discount to use a less-expensive card; (2) free goods to use a less-expensive card; (3) free services (*i.e.*, shorter checkout line, free delivery, free parking, preferred seating, or the like); or (4) merchant-sponsored reward points. Pet. App. 219a. Even if one

assumes that the effect on cardholders should be included in the competitive analysis, the district court correctly held that there is no reason to believe that the cardholder is better off if he or she receives reward points from Amex, but is never given the choice of receiving the incentive, discount, benefits or reward points that the merchants would offer if they were allowed to do so. *Id.* Indeed, a consumer is necessarily better off if he or she is given a choice between (a) using the Amex card and receiving Amex reward points or (b) switching to an alternative card and receiving the merchant-offered discount, benefit or incentive. If the consumer really prefers the Amex card and the Amex rewards, he can use the Amex card. It is only when a consumer prefers the merchant incentive, reward or discount that Amex will lose a transaction. But if the consumer prefers the merchant reward or incentive, Amex should lose the transaction. The explicit purpose of the anti-steering rules is to prevent the consumer from being offered that pro-competitive choice.

The Second Circuit incorrectly assumed that consumers are better off if they are offered Amex rewards and are given no opportunity to choose an alternative incentive offered by the merchant. In reality, the consumer is necessarily better off, and competition is enhanced, if he or she has the ability to choose his or her preferred reward, discount or incentive. Amex may believe that the consumer is better off if he or she uses the Amex card, but that is a decision that only the consumer can make. It is the ability of the consumer to be offered and make that procompetitive choice that is targeted and eliminated by Amex's anti-steering

rules.[8] The elimination of that procompetitive, consumer choice is an adverse effect on competition. Amex has offered and the Second Circuit has identified no legally cognizable procompetitive justification for that adverse effect on competition. As a result, it violates the Rule of Reason. *Ind. Fed'n of Dentists*, 476 U.S. at 460-62 (even where the challenged conduct is not a naked restraint, obstructing consumers' ability to choose a desired product or service violates the Rule of Reason); *Nat'l Soc'y Prof'l Eng'rs*, 435 U.S. at 692-93 (preventing consumers from comparing price in order to make a purchase choice violates the Rule of Reason).

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[8] Amex has argued that, like vertical price-fixing, its anti-steering rules are intended to increase interbrand competition. Nothing could be further from the truth. In a vertical price-fixing case, a manufacturer prohibits its distributors from either raising or lowering the resale price of the manufacturer's product. Potentially, at least, that will allow the manufacturer's product to better compete against the products of other manufacturers, *i.e.*, interbrand competition. Here, Amex allows merchants to either raise the price charged to customers who use an Amex card (*i.e.*, a surcharge) or lower the price charged to the user of an alternative card *so long as the other card is surcharged the identical amount that Amex is surcharged or Amex's card is granted the identical discount that the alternative card receives. See* J. A. 97. The merchant is free to offer discounts or impose surcharges *so long as the price charged for using the Amex card and the competitive cards* ***is*** *identical* – meaning that interbrand price competition is literally prohibited.

D. The Government Proved an Injury to Consumers[9]

Neither Amex nor the Second Circuit denies that horizontal price competition among credit card networks for the sale of credit card services to merchants is injured by Amex's anti-steering rules. Instead, Amex argues that the Government's initial burden required additional proof that hypothetical benefits to cardholder competition did not outweigh the injury to competition for the sale of credit card services to merchants. The law, however, does not allow a competitive injury in one sector to be offset by a supposed competitive benefit in another sector. *U.S. v. Topco Ass'n, Inc.*, 405 U.S. 596, 609-10 (1972) (holding that courts have "an inability to weigh, in any meaningful sense, destruction of competition in one sector of the economy against promotion of competition in another sector"). But, even if it were permitted, the manner in which the Second Circuit weighed an injury to competition in one market against a hypothetical benefit to competition in another market is plainly incorrect.

Contrary to Amex's view, not all consumers, and possibly none of them, receive a benefit when Amex passes on some of its anticompetitive increase in merchant prices to its cardholders in the form of reward points. First, the vast majority of retail

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[9] The trial court correctly held that merchants "are the relevant consumers" of the network services sold to them by Amex. Pet. App. 70a. Merchants clearly suffer antitrust injury when the prices they pay "rise dramatically" due to the elimination of price competition among the sellers of the service they purchase. Pet. App. 71a. This section of this *Amicus* Brief explains that retail customers, who are the consumers of the services sold to cardholders, are also injured by Amex's anticompetitive conduct.

consumers do not use Amex cards and do not receive any Amex reward points. Because the retailers pass on to all of their customers the higher cost of the merchant fees (Pet. App. 68a, 192a, 210a-11a), the consumers who do not carry or qualify for an Amex card suffer a dead-weight loss. Pet. App. 211a. They receive no Amex rewards or benefits, but must pay higher merchant prices. *Id.* Those consumers are also deprived of the rewards and incentives that merchants would offer to customers to refrain from using the relatively high-cost Amex card.[10]

Second, even the Amex cardholders may be worse off. It is undisputed that Amex, at most, passes on only a fraction of its merchant fees to cardholders.[11]

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[10] Amex may object that under the principles of *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977), it is impermissible to take into consideration the price effects on consumers that is passed on to them by the injured merchants. It is Amex, however, who argues that the Court should take into consideration the impact of higher merchant fees which are allegedly passed on by Amex to its cardholders in the form of higher rewards points. Amex cannot have it both ways. If the pass-on effects on the consumers who use the Amex card and receive Amex reward points is considered, then the effect on the consumers of the higher merchant credit card fees that are passed on to them in the form of higher retail prices must be taken into consideration, as well.

[11] Amex spends less than half of its revenue from merchant fees on the reward points that it gives to cardholders. Pet. App. 209a-10a, Tr. 3572 (Silverman/Amex). Amex admitted that a significant part of the premium fees it receives from merchants drop to its bottom line. Pet. App. 209a. In fact, Amex admitted that it could reduce merchant fees by $1 billion while keeping cardholder rewards at the same level. Only shareholder return would go down. Tr. 3537 (Silverman/Amex). Amex further admitted that there is no direct connection between the level of merchant prices it charges and the amount of rewards that it gives to cardholders. Tr. 3575 (Silverman/Amex).

Depending on what products Amex cardholders buy, and how the merchant prices its various products in order to recoup the excessively high merchant fees, even Amex cardholders might pay a higher net price than they otherwise would due to Amex's anti-steering rules.[12] Amex came forward with no evidence to show that its anti-steering rules result in its cardholders receiving additional reward points that are of greater value than the amount by which the products they purchased go up in price. The burden of coming forward with such evidence was on Amex. Having failed to meet that burden, its conduct violated the Rule of Reason.

Third, if one considers all retail consumers as a group, it is undisputed that because of Amex's anti-steering rules those consumers pay an increase in retail prices that are greater than any increase in the value of reward points given out by Amex. This is true because (1) the merchants pass on any increase in the cost of accepting Amex cards to their customers (Pet. App. 68a, 192a, 210a-11a), and (2) Amex uses only a fraction of the fees it receives from merchants to purchase rewards for cardholders[13] and often passes on none of the revenue from its merchant price increases to its cardholders.[14] A significant portion of

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[12] In other words, the retail price of the goods that an Amex cardholder buys might go up more than the value of the reward points that he or she receives.

[13] *See* n.11, *supra*.

[14] From 2005-2010, Amex's merchant price increases "resulted in $1.3 billion in incremental income." Pet. App. 170a. Those price increases "were not paired with offsetting adjustments on the cardholder side of the platform." *Id.* at 166a-67a; *see also id.* at 209a. Amex admits that not all of its "gains from increased merchant fees are passed along to cardholders." *Id.* at 51a.

Amex's price increases to the merchants drops to Amex's bottom line for the benefit of its shareholders. Pet. App. 209a; Tr. 3572 (Silverman/Amex). Consumers, as a group, get back significantly less in rewards than they must pay to cover the increase in retail prices. Contrary to the Second Circuit's view, the "net" price effect of Amex's anti-steering rules is known. Amex's profits go up and retail customers pay more for the goods they receive – even if one subtracts the value of Amex rewards.

The defect in the Second Circuit's reasoning is simple. It treats the reward points given to Amex cardholders as a free benefit that can be subtracted from the increase in price paid by the merchants. The reward points, however, are not free. They are paid for by merchant fees, and the merchants pass that amount on to the consumers. If Amex gave back to all of the consumers the full amount of the increase in fees that it collects from the merchants in the form of rewards to consumers, the transaction would be a wash – at least as to the consumers. But Amex does not do that. It gives back reward points to only some of the consumers and gives back less than it takes in from the merchants and less than the merchants pass on to the consumers in the form of higher prices. The obstruction to interbrand price competition for the sale of credit card services to merchants that is caused by the anti-steering rules has only one winner – Amex. The merchants and the retail consumers both suffer a net loss.

III. The Need to "Balance" the Prices Charged to Both Sides of a Two-Sided Platform Is Not a Procompetitive Justification

In order to be successful a credit card network must attract customers to both sides of its platform. Pet. App. 9a. This is because a cardholder might not want to hold a card unless it is accepted at enough merchants and a merchant might not want to accept a card unless it is used by a sufficient number of customers.[15] The Second Circuit held that a credit card platform must therefore "find an effective method for balancing the prices on the two sides of the market." *Id.* This, according to the Second Circuit, puts cardholders and merchants in opposition to each other because merchants want to pay a lower price and cardholders want to receive more reward points. Pet. App. 10a, n.10.

The Second Circuit held that the two sides of the payment card platform have different "demand sensitivities" (*i.e.*, price elasticity of demand) (Pet. App. 9a, n.9); that the cardholders are less willing to pay to use a card than the merchants are to accept a card; and, that Amex, therefore, seeks to "balance the two sides of its platform" by charging cardholders a lower price (*i.e.*, more reward points) and charging merchants a higher price. The high merchant price results in merchants wanting to steer customers away from the higher-cost Amex cards and to lower-cost cards by giving the customers discounts, or other incentives to use the lower-cost cards. As previously stated, the use of such discounts or incentives, if permitted, would

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[15] If accepting an additional card imposes no or very low marginal costs on the merchant, the merchant will likely accept a card even if it is used by very few customers.

stimulate price competition between the credit card networks as each network would seek to lower its price so that merchants would steer consumers to its cards rather than away from its cards. In other words, if merchants are allowed to steer to lower-cost cards, the networks will have to compete on price by cutting the merchant price in order to avoid the loss of sales volume that would result from merchant steering. Pet. App. 71a. In the alternative, a card network might keep its merchant price high, but suffer the procompetitive consequence of lower sales volume – just as should happen in a competitive market.

The Second Circuit, however, holds that the use of differential pricing by the merchants to steer consumers to lower-cost credit cards, and the interbrand price competition that it stimulates, "can be harmful insofar as it interferes with the network's ability to balance its two-sided net price." Pet. App. 21a. A merchant's ability to steer, however, does not interfere in any way with Amex's ability to "balance" the prices it charges to either side of the platform or to set any price it wants for both merchants and cardholders. Amex is free to choose any merchant price and any cardholder price that it prefers. The right of a seller to set its price or to seek to "balance" the prices it charges the two sides of a platform does not, however, imply a right to obtain those preferred prices in the face of the interbrand price competition that would lead to different competitively determined market price or "balance." Competition, not Amex's preference for a certain price pair, must determine the market prices on both sides of the platform. *See* Areeda & Hovenkamp, *Antitrust Law*, 2017 Supplement, ¶562(e), p. 101 (stating that the Second Circuit "failed to see . . . that under the antitrust policy *competition* should choose the optimal mix of revenue as between the two sides . . . . "). The

Sherman Act precludes Amex from obstructing price competition so as to achieve the prices or "balance" it prefers. As a matter of law, it is the free market mechanism that makes that decision – not Amex.

CONCLUSION

The Second Circuit leaves undisturbed the district court's findings that Amex's anti-steering rules (1) stifle interbrand price competition for the sale of credit card services to merchants, (2) erect barriers to entry, especially to low-price providers, into a highly concentrated industry, (3) eliminate consumer choice, and (4) raise the prices that millions of consumers, who receive no Amex reward points, pay for goods and services. Amex does not assert that these findings are clearly erroneous. Because these adverse effects on competition were proved by direct evidence, and because network cardholder services and network merchant services cannot as a matter of law be in the same relevant market, there is no need for further detailed market analysis.

Under the Rule of Reason, the burden of coming forward with evidence of offsetting procompetitive effects was on Amex. Even if alleged procompetitive effects in the cardholder market could be used to offset an injury to competition in the merchant market, it is clear that Amex failed, both legally and factually, to present evidence of any legally cognizable procompetitive effect.

Thus, under the Rule of Reason, the Government proved an adverse effect on competition and Amex failed to demonstrate any procompetitive effect. As a result, a Rule of Reason violation has been proved. *Amici*, therefore, respectfully submit that this Court should reverse the Second Circuit ruling and remand

this case with instructions to affirm the judgement of the district court.

Respectfully submitted,

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